

Testimony of David C. Quam, General Counsel to the International AntiCounterfeiting Coalition, Inc., before the United States Sentencing Commission

March 23, 2000

On behalf of the 180 members of the International AntiCounterfeiting Coalition, Inc. ("IACC") let me thank you for holding this hearing and giving us the opportunity to testify. My name is David Quam and through the firm Powell, Goldstein, Frazer and Murphy LLP, I serve as General Counsel to the Coalition.

The IACC would like to commend the Commission and its staff for the work it has done on this issue and express its support for proposed Option 4. Although the IACC recommends a slight modification to Option 4, we believe that this approach best captures the complexities associated with trademark and copyright crimes while complying with the directive set forth in the No Electronic Theft Act ("NET Act").

I. Background

The IACC is a non-profit trade association formed to advocate for the effective protection and enforcement of intellectual property rights in the United States and abroad. Comprised of more than 180 members, including manufacturers, business trade associations and professional service firms, the IACC is the largest organization dedicated solely to combating trademark counterfeiting and copyright piracy.

Our members represent a cross-section of industry ranging from auto, apparel, and luxury goods manufacturers, to pharmaceutical, consumer product, software, and entertainment companies. Consumers who purchase the products of IACC members use trademarks and trade names to identify the source of the goods and provide assurances with regard to quality, safety and reliability. Counterfeiting and piracy undermines consumer expectations by stealing the intellectual property and underlying reputations of legitimate manufacturers to sell inferior products for quick profits.

A. The Importance of Adequate Protection for Intellectual Property

For the past several years Congress and the Administration have used legislation and international trade negotiations to underscore the importance of providing effective and adequate protection of intellectual property rights. Legislatively, Congress passed a series of bills including the Anticounterfeiting Consumer Protection Act¹ to enhance intellectual property protections and provide additional weapons to fight counterfeiting and piracy, and the NET Act² to address the growing problem of online infringements.

¹ Pub. L. 104-153 (1996).

² Pub. L. 105-147 (1998).

Congress also took steps to protect against the dilution of famous trademarks³ and to recognize intellectual property rights in disputes over Internet domain names.⁴ The importance of intellectual property is also a driving force behind the aggressive stance taken by the United States Trade Representative in dealing with U.S. trading partners around the globe.

The attention given to intellectual property issues is due in large part to a growing awareness of the harm counterfeit and pirated goods pose to consumers, industry, and the economy. In 1982, counterfeiting cost the U.S. an estimated \$5.5 billion.⁵ Today, the problem has become an epidemic, generating losses of over \$200 billion in the United States⁶ and more than \$350 billion worldwide.⁷

This explosive growth has been accompanied by a migration in the availability of counterfeits and pirated goods from traditional locations like city streets, flea markets, swap meets, and sports stadiums to suburbs, strip-malls, and the shelves of leading retail stores. Increasingly, many of these counterfeit products present public health and safety risks, finance organized crime, and adversely impact the U.S. economy. The following examples illustrate the extent of the problem:

1. Health and Safety: Head and Shoulders shampoo and counterfeit-labeled infant formula, which represent serious public health and safety risks, were found in retail stores. Other examples of dangerous counterfeits include food products, pharmaceuticals, children's toys, airplane and automotive parts, and eyewear.
2. Organized Crime: Law enforcement officials recently broke up a Los Angeles-based software piracy ring controlled by three Chinese organized crime groups. They seized millions of dollars worth of counterfeit Microsoft software, as well as plastic explosives, TNT, shotguns, handguns, and silencers. In a separate case, police in New Jersey seized thousands of counterfeit designer handbags that were being used to further a drug trafficking scheme--heroin was stitched into the lining of the counterfeit handbags.⁸
3. Impact on the Economy: Counterfeiters and pirates do not pay taxes. New York City alone loses over \$400 million a year in lost sales and excise taxes due to the sale of counterfeit goods and the U.S. Customs Service estimates that hundreds of

³ "Trademark Amendments Act of 1999," Pub. L. 106-43.

⁴ "Intellectual Property and Communications Omnibus Reform Act of 1999," Pub. L. 106-113.

⁵ United States International Trade Commission, 1982.

⁶ Michael Finn, *Foiling Counterfeiters*, TRADEMARKS AM., April 1994.

⁷ *Countering Counterfeiting*, International Chamber of Commerce, Counterfeiting Intelligence Bureau, April, 1997, at 13.

⁸ In testimony before the International Trade Subcommittee of the House International Relations Committee on October 13, 1999, Customs Commissioner Kelly stated:

"Our investigations have shown that organized criminal groups are heavily involved in trademark counterfeiting and copyright piracy. They often use the proceeds obtained from these illicit activities to finance other, more violent crimes. These groups have operated with relative impunity. They have little fear of being caught - for good reason. If apprehended, they face minimal punishment. We must make them pay a heavier price."

thousands of Americans lose their jobs every year due to counterfeiting and piracy. Small legitimate retailers and entrepreneurs also suffer as they are forced to compete with companies and retailers selling illegal low-cost fakes.

Our members, manufacturers of some of the best known products in the world, collectively invest billions of dollars in developing, testing, manufacturing, marketing and advertising goods and services to ensure that their products are safe, reliable, and meet high quality standards. Those who counterfeit trademarked goods or willfully infringe copyrighted works are stealing not only sales, but also a rights-holder's investment in creativity, time, capital, and labor. In other words, the theft of intellectual property causes damage far beyond any one-time loss associated with a lost sale. The difficulty facing the Commission is creating an amendment that incorporates both monetary loss and the harm caused to reputations and goodwill, lost productivity and jobs, and diminished consumer, wholesaler and retailer confidence in a brand. Any attempt to judge the severity of counterfeiting or piracy by measuring only pecuniary harm as represented by lost sales will necessarily understate the true damage caused by counterfeiters and pirates.

The IACC and its members maintain that the only way to effectively deter counterfeiting is to assure that counterfeiters receive jail time for their actions. Stringent criminal penalties are necessary because the nature of counterfeiting and piracy as illicit underground operations do not lend themselves to civil enforcement. Actual damages are difficult to prove because offenders operate in cash and keep very few records. Indeed, most counterfeiters and pirates treat civil damage awards and fines as merely the cost-of-doing-business. The only real deterrent to counterfeiting is the imposition of criminal penalties that result in actual jail time served.

B. Establishing Effective Guidelines

The current guidelines for offenses under 18 U.S.C. §§2318, 2319, 2319A and 2320, do not adequately deter counterfeiting and piracy due to the high monetary thresholds required to impose meaningful sentences. The difficulties experienced by members of the IACC in obtaining federal enforcement on account of the nominal penalties currently imposed pursuant to the Guidelines is well-documented. Congress recognized this shortcoming and the need to increase the actual length of sentences awarded for trademark and copyright offenses when it directed the Commission to enhance penalties associated with such crimes.

Changes in the Federal Sentencing Guidelines will also have an impact on U.S. efforts to encourage intellectual property protection abroad. The United States is the leading advocate of stronger, more effective and deterrent penalties for intellectual property violations internationally. Through the use of domestic trade law provisions like the Special 301⁹ and multilateral tribunals such as the World Trade Organization, the United States works to persuade trading partners to strengthen their national laws to combat and deter counterfeiting and piracy. The United States' ability to effectively

⁹ See, 19 U.S.C. §2242.

advocate for changes abroad is directly effected by the strength of its own laws. Sentencing guidelines that fail to provide strong penalties under U.S. law will undermine the Government's efforts abroad and provide trading partners with a basis to argue that the United States itself lacks the political will to impose strict penalties.

The IACC, therefore, respectfully urges the Commission to adopt changes to current Guideline 2B5.3 that are consistent with congressional directives, create a meaningful deterrent, and properly reflect the seriousness of the offenses of trademark counterfeiting and copyright piracy.

II. Recommendations

The Commission put forth four alternative proposals for amending Section 2B5.3. Ultimately, the IACC recommends that the Commission adopt an amendment that embodies each of the following elements:

1. Offense levels based primarily on the retail price of the infringed upon items multiplied by the quantity of items involved in the offense. Reliance upon the actual price of legitimate product, instead of the value of the infringing, more accurately reflects the injury to the intellectual property rights holder, and provides greater certainty for both prosecutors and the Courts in applying the guidelines, thereby advancing one of the key objectives of the Sentencing Commission.
2. Across the board enhancements for all intellectual property crimes. Any amendment should not favor one form of intellectual property over another.
3. Increased levels for offenses involving conscious or reckless risk of serious bodily injury or death. Cases involving products that pose health and safety risks warrant increased punishment.
4. Recognition of the role of organized crime in counterfeiting and piracy. High profits and low risks continue to attract organized crime groups to counterfeiting and piracy.

Using these criteria, the IACC supports Option 4 with one recommended change: combine specific offense characteristics (b)(2)(B) and (b)(2)(C) into a single inclusive SOC.

The IACC's main criticism of Option 4 stems from the inclusion of "greatly discounted merchandise," and "substantially inferior" as SOCs that separately result in a 2 level decrease. The IACC is concerned that these provisions only serve to reward counterfeiters and pirates that sell substantially inferior merchandise (as distinct from marginally inferior merchandise) at substantially reduced prices (instead of marginally discounted prices).

If the Commission wishes to make a distinction between classes of infringing items based on price and quality, it should do so by considering both characteristics as a whole. Price alone may be an indicator that goods are false, but if the infringing products

are of decent quality, they may translate into a one-for-one sales loss that is properly captured without a 2 level decrease. Likewise, poor quality may call into question the authenticity of a product, but if counterfeiters and pirates find that they can sell cheap knock-offs at higher prices, they most certainly will. Finally, digital technology now allows for near perfect reproduction of some works. The IACC does not believe that copyright pirates making exact copies of popular software, music or videos should benefit from a 2 level decrease simply because they sell their products cheaply. Consequently, the IACC recommends that the Commission amend Option 4 to call for a 2 level decrease when the offense involved greatly discounted merchandise **and** the quality or performance of the infringing item was substantially inferior to the quality or performance of the infringed item.

III. Conclusion

The IACC commends the Commission for its hard work in devising a guideline to capture the many nuances of intellectual property crimes. Trademark counterfeiting and copyright piracy are serious crimes. They discourage creativity, devalue investment, harm reputations, and often defraud consumers. Limited law enforcement resources and minimal penalties, however, have made criminal enforcement of intellectual property rights a low priority at the federal level. The enhancements proposed by the Commission in Option 4 will help to encourage prosecutions and, more importantly, deter future counterfeiting and piracy.